



BUSINESS SEPARATION

COMPLIANCE

Annual Report

April 2014 – March 2015

SP Transmission Plc.

SP Distribution Plc.

SP Manweb Plc.

1. Introduction

SP Transmission plc, SP Distribution plc and SP Manweb plc are the licence holding companies ('the Licence Holders') within the regulated business of the Scottish Power group. Each of these companies has a board of directors consisting of individuals who are separate from the liberalised business of the Scottish Power group.

SP Transmission plc's licence and the distribution licences of SP Distribution plc and SP Manweb plc contain specific confidentiality and business separation provisions. These include a requirement to submit a Compliance Statement for approval by the Gas and Electricity Markets Authority setting out the procedures whereby the licensee will ensure compliance with the relevant business separation licence requirements. An annual compliance report to the Gas and Electricity Markets Authority (Ofgem) is also required. This report describes the measures put in place by each of the Licence Holders to meet business separation requirements in the period April 2014 to March 2015.

In 2010, the licensed companies were involved in work to reconfigure the structure of holding companies in the Scottish Power group with the explicit aim of ensuring a stronger governance environment and very clear business separation of the network business, SP Energy Networks, from liberalised activities. In particular, this involved the establishment of three new holding companies, one for the Renewable Generation businesses, another for Energy Retail, other Generation and Energy Trading businesses in the group and the third for the regulated networks businesses (SP Transmission plc, SP Distribution plc and SP Manweb plc, together with SP PowerSystems Ltd) which is called Scottish Power Energy Networks Holdings Limited. This new legal structure took effect from July 2011 (except for the holding

company for Renewables Generation which took effect from January 2012). The Board of Directors of Scottish Power Energy Networks Holdings Limited is responsible for the effective day to day operation of the regulated networks businesses within the Scottish Power group and consists of directors who have no relationship within the liberalised business. In addition, three non-executive independent directors have been appointed to the board of the licencees and SP Energy Networks Holdings Limited. They provide independent scrutiny of the financial ring fencing obligations for each licensee, governance, performance and strategic direction of the business. This reinforces the very clear business separation of the networks business from liberalised activities.

The above licences also state that each Licence Holder must appoint a Compliance Officer to advise it on business separation compliance and to monitor procedures in place to meet these requirements. Juliet Farquhar is the current Scottish Power Compliance Officer.

2. Measures adopted in accordance with the SP Energy Networks Business Separation Compliance Statement

2.1 Managerial Separation

The Supply and Distribution Businesses in the Scottish Power group are managerially and operationally separate, reporting to different Directors. The Utilities Act 2000 required companies to create separate legal entities for their electricity distribution and supply businesses. SP Distribution plc and SP Transmission plc respectively hold the distribution and transmission assets and licences for Central and Southern Scotland. SP Manweb plc holds the distribution licence for Merseyside and North Wales. As earlier indicated in paragraph 1, the restructure within the

Scottish Power Group had the main objective of protecting the integrity of its assets and avoiding the contamination of risks and responsibilities between its companies.

Scottish Power Energy Networks Holdings Limited is responsible for the Licence Holders and for the effective management and day to day operation of the regulated business within the Scottish Power group. SP PowerSystems Ltd, also a wholly owned subsidiary of SP Energy Networks, manages and operates the network assets on behalf of the Licence Holders.

The Scottish Power corporate office supports the divisional directors in discharging their responsibilities to shareholders including their legal obligations but has no role in managing the day to day operation of the businesses within the group.

2.2 Responsibility and Monitoring

The SP Energy Networks Network Planning & Regulation Director has responsibility for compliance requirements within the Distribution and Transmission Licences held by the group. A Compliance Manager within the Regulation Department has responsibility for the day to day management of business separation compliance.

Susan Bradshaw, Licence Development & Assurance Manager is our current Compliance Manager.

The Compliance Manager has established monitoring processes and communicates regularly with the Compliance Officer to discuss any issues arising.

We are confident that the monitoring has been effective and is supported by the regulatory culture that exists within the SP Energy Networks businesses.

2.3 Branding

SP Distribution plc and SP Manweb plc are required to maintain a distribution brand that is distinct from the brand used by an affiliated supplier. Our approved brand is currently “SP Energy Networks” which was implemented in 2008.

2.4 IT Systems and protection of Confidential Information

Where there are systems shared with other businesses in the group, access arrangements are in place to ensure that confidential data concerning suppliers out with the Scottish Power group, or their customers, is not available to any affiliated supply or generation business. During 2014/15 work has taken place to provide appropriate separation and access controls for new systems replacing legacy systems that include confidential network data.

All staff are required to respect confidential information. A Compliance Code of Conduct has been established that is communicated to all Energy Networks staff, that sets out the licence restrictions on the transfer of confidential information. Information that is of a corporate nature, as agreed with Ofgem, is shared with other businesses within the Scottish Power group as required.

During the period of this report, no breaches of business separation were identified in relation to information separation. Management controls have operated as intended throughout the compliance period, however minor improvements have been identified to enhance the control environment. These improvements will be implemented during 2015/16

2.5 Staff Movements

Staff transfer guidelines are embedded into the Human Resource process within SP Energy Networks. Where deemed appropriate, members of staff transferring from the Distribution or Transmission businesses are subject to an assessment by the SP Energy Networks Compliance Manager and their Line Manager with respect to their current duties and information which they have access to as detailed in the staff transfer guidelines. The process involves monthly updates on staff movements from Human Resources. Upon identification of any relevant staff transfers an assessment of the individual's access to confidential information is completed to determine whether a period of quarantine is required. A decision about the duration, if any, of a period of quarantine is made following consultation with the Compliance Officer. The procedure is in place for an assessment to be carried out prior to a transfer of this kind taking place. Quarantine arrangements were applied in one case in accordance with licence requirements during the compliance period.

2.6 Shared Sites

In a number of cases sites are shared between supply and distribution. In all cases SP Energy Networks' staff are physically segregated from other Scottish Power business staff with appropriate access controls and restrictions in place. An electronic security tag system is in place and access privileges are controlled and monitored via a secure database. Dedicated 'Security Access Control' staff are responsible for the management and update of the database and the processing of access requests. Access requests are only processed following appropriate authorisation.

During the period of this report, the main shared premises were visited to confirm ongoing compliance with licence requirements which included testing the operation of the electronic security access systems and reviewing the access controls database in each location. During the period of this report no breaches were identified in relation to shared sites.

2.7 Non-discrimination requirements

The distribution licence requires us to provide certain metering and data services in a non-discriminatory way. It also requires us not to discriminate in carrying out connections, in providing for modifications to or retentions of existing connections. Our business separation licence conditions require us to report on compliance with these obligations in so far as they concern our relations with affiliated suppliers or gas shippers.

Compliance with these provisions is ensured by SP Distribution plc and SP Manweb plc by the following measures:

(1) Use of standard agreements and terms

Provision of legacy metering equipment and data services is governed by charges applicable to all suppliers as set out in the charging statement required under Condition 36 of our distribution licence. Dataserve UK provides this service on behalf of Energy Networks under the terms of a Service Level Agreement which is monitored and reviewed by a contract manager within SP Energy Networks.

In the case of connections, our charging statements issued under Condition 14 of the distribution licence, set out the bases for charging for “licensed” (S16) connections,

and for non-contestable work in the case of connections to be adopted from a third party. In both cases, we employ connection agreements that apply equally to all parties (for larger sites, site-specific connection agreements are used). These are subject to the provisions of the Distribution Connection and Use of System Agreement.

(2) Training and audit

Managers and staff dealing with third parties seeking use of system, connection or metering services or changes to these are subject to the training and awareness regime described earlier in order to ensure that they behave in a non-discriminatory manner and that they are aware of the importance of observing business separation compliance.

2.8 Non-cross-subsidy

We are also required to report on our compliance with the licence obligation not to cross-subsidise or receive a cross-subsidy from any other business of the licensee or an affiliate or related undertaking.

Our compliance with this obligation is underpinned by means of arm's length trading with other parts of the Scottish Power group. Provision of services by SP Distribution plc and SP Manweb plc, including use of system, to other companies in the group takes place under standard terms and charging methodology that apply equally to third parties.

SP PowerSystems Limited ('SPPS') contracts with an affiliate, Iberdrola Engineering and Construction Limited ('IEC') to provide engineering and technical management of grid related projects at 132 kV and above. Charging and other arrangements have

been designed to ensure compliance with non-cross subsidy, non-discrimination and other relevant requirements, including an undertaking by IEC to SPPS to (i) ensure that IEC's dealing with a third party do not involve a cross-subsidy being given to or received by SPPS in relation to an affiliate or related undertaking to SPPS, and (ii) prevent the restriction, distortion of competition in the generation or supply of electricity or in any services related or ancillary to such activities

2.9 Transmission

The business separation requirements in SP Transmission plc's licence are broadly similar to those applicable to distribution licensees. There is a prohibition on the licence holder from disclosing or authorising access to information relating to or deriving from the management or operation of the transmission business to any person engaged in any other electricity business. There is also a requirement for the full managerial and operational independence of the transmission business from other businesses and the appointment of a Managing Director of Transmission. Additionally, there is provision for the appointment of a Compliance Officer and reporting requirements relating to business separation.

Ofgem has granted a derogation which permits the joint management and operation of Scottish Power's distribution and transmission businesses. The compliance measures described above in relation to distribution, such as awareness training for staff, and compliance procedures for staff transfers are applied to the transmission business also.

In accordance with the requirements of Special Licence Condition 1 of SP Transmission's licence, during 2014 a report relating to the resources for operating

the transmission business was issued by the Managing Director of Transmission and is available on the SP Energy Networks website (SPEnergyNetworks.co.uk).

During 2012 SP Transmission was granted a derogation against the full unbundling requirements of the Electricity Directive 2009/72 under the provisions of section 9(9) of the Directive. SP Transmission Directors are required to certify annually to Ofgem that no changes have taken place that breach the eligibility requirements for this derogation. A certificate to this effect was submitted to Ofgem in July 2014.

3. Staff Training and Awareness

A number of actions have been put in place to reinforce awareness of the importance of maintaining confidentiality of information and non-discrimination between suppliers and generators. A Compliance Code of Conduct applies to all SP Energy Networks staff and is published on the divisional intranet. During 2014/15 all SP Energy Networks staff have been reminded each quarter of the key requirements of business separation compliance. Staff training was reviewed in 2014/15 and an area identified as requiring minor improvement was the Security Access Control team. The Security Access Control team is a corporate function that manages the access to all Scottish Power sites. Business separation awareness training was given to security access personnel to ensure they could help meet SP Energy Networks business separation obligations.

4. Complaints or Representations

No formal complaints regarding potential breaches of our business separation requirements have been received during the year and this reflects positively on the effectiveness of our monitoring procedures and staff awareness programmes.

5. Further Information (Compliance Manager Activities)

The Compliance Manager adopted a risk-based approach, concentrating on the areas with the greatest potential impact on business separation compliance. A summary of activities carried out by the Compliance Manager's team during the period covered by this report are set out in the attached appendix.

Compliance Activity Programme - Summary 2014/15

Key Activities	Key Controls	Work carried out
Physical Separation	<ul style="list-style-type: none"> • Regular communication to staff regarding Business Separation requirements • Physical separation through security access controls • IT access controls 	During the period of this report, the main shared premises were visited. Reviews were carried out to confirm ongoing compliance with licence requirements which included testing the operation of the electronic security access systems and reviewing the access controls database in each location.
Staff Transfers	<ul style="list-style-type: none"> • Regular communication to staff regarding Business Separation requirements • Proactive notification to Compliance Manager of Staff movement/ transfers • Monthly Human Resource report on Staff movement/ transfers • Staff transfer risk assessment • Quarantine Controls, as appropriate 	Staff Transfer guidelines are fully embedded into the Human Resources process within SP Energy Networks. We have reviewed all movers, transfers and leavers within 2014/15 and completed and retained all necessary risk assessments. One transfer was deemed as high risk in this period and suitable steps were taken to ensure that a 3 month quarantine period was taken.
IT Systems, Processes & Procedures	<ul style="list-style-type: none"> • Regular communication to staff regarding Business Separation requirements • IT access controls • Ongoing review of user access 	IT specialists in our Internal Audit Department have reviewed the controls in place for our remaining shared IT systems. No breaches of business separation requirements were found, but minor improvements to management of user access controls were identified and are being implemented.
Staff Training and Awareness	<ul style="list-style-type: none"> • Regular communication to staff regarding Business Separation requirements 	This year regular staff communications were completed to ensure staff awareness of their responsibilities in regard to Business Separation.
Managerial Separation	<ul style="list-style-type: none"> • Regular communication to staff regarding Business Separation requirements • Service Level Agreements with service providers within the Scottish Power group 	Managerial Separation is embedded into the way we do business with service providers within the Scottish Power group. Contract Managers are in place to monitor compliance with our SLA's.

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